Statement of

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Mr. Chairman and Members of the Subcommittee, I am James F. Higgins, President and Chief Operating Officer of Dean Witter Financial, a unit of Dean Witter, Discover & Co.[1] Thank you for inviting me to share our views on the issue of financial services modernization.

On February 5th of this year, Dean Witter, Discover & Co. and Morgan Stanley Group, Inc. announced an agreement to merge, to become a preeminent global financial services firm, providing securities, asset management and credit services to investors and consumers worldwide. Like other recent well-publicized transactions, our planned merger illustrates that much is changing in the financial services industry. Prompted by international competition, technological developments, and changing consumer needs, financial services providers in the banking, securities and insurance sectors increasingly find themselves competing across industry lines. Unfortunately, on a daily basis, we also find ourselves confronted with unnecessary obstacles to competition that result from an antiquated legal structure.

[1] Dean Witter, Discover & Co. is a diversified financial services organization that provides a broad range of nationally-marketed credit and investment products, with a principal focus on individual customers. The Company has two lines of business: **Credit Services --** the largest single issuer of general purpose credit cards in the United States as measured by number of accounts and cardmembers -- providing general purpose credit cards (the Discover® Card, the Private Issue® Card, the BRAVOK Card and affinity program cards), transaction processing services, private-label credit card services and real estate-secured loans; and **Securities --** the third largest domestic securities firm with 9,252 account executives in 371 branch offices, serving the investment needs of over three million individual and institutional clients with assets of $254.4 billion -- providing a variety of financial products, services and investments.

We are pleased that the Subcommittee is beginning consideration of legislation to amend these laws. Financial services modernization legislation is important, and needs to be enacted soon. With your support, legislation can readily be crafted to work for all affected parties: industry, consumers and regulators. The Commerce Committee's success in modernizing our nation's telecommunications laws makes me optimistic that another legislative landmark is at hand. A new framework for offering financial services that will work well into the next century can become one of the most important achievements of the 105th Congress.

Need for Congressional Action

Consumers of financial services, as well those who provide those services, are ill-served by the current regulatory structure. Communications and computer technology are enabling what Bill Gates calls "friction free capitalism" and the promise of more individualized services to a greater number of consumers and investors at increasingly competitive prices. In the financial services arena, this means -- in theory -- that every consumer can have access to the broadest range of banking, securities, insurance and other financial services. Just as important, it means that these services can be obtained from a source with which each consumer is most comfortable and finds most convenient, whether it be through the Internet or from a bank officer, stockbroker or insurance agent whose advice has proven helpful in the past.

But the potential benefits offered by technologies available today cannot be realized under a legal structure created before the era of the rotary-dial telephone. Provisions of the

Glass Steagall Act and the Bank Holding Company Act that were enacted to address concerns which are no longer pertinent, need to be changed. Today, these requirements serve less as consumer and systemic protections than as challenges to financial services providers to find ways to serve consumers through favorable regulatory action, judicial constructions and creative legal interpretations. But this type of reform does not serve the nation well, because it creates a patchwork of rules which do not necessarily address the needs of investors, or treat industry segments fairly. The situation cries out for Congressional attention.

The need for action by Congress is not new. Ten years ago, Congress enacted the "Competitive Equality Banking Act" which imposed a temporary moratorium on the authority of regulators to authorize banks to engage in new securities, insurance, real estate and other activities. It also limited the ability of nonbanking businesses to provide banking services through limited-purpose bank charters. All of this was done with the understanding that Congress was on the verge of enacting "comprehensive" changes to the financial services laws, and the conviction that decisions affecting the structure of the financial services sector should be made by Congress, rather than industry members or bank regulators.

A decade later, though some reforms have been enacted into law (e.g., interstate banking authority), comprehensive legislation updating the rules governing the delivery of financial services has yet to be enacted. Decisions continue to be made on an ad hoc basis by regulators, and marketplace forces are continuing to blur the distinctions between commercial banks, investment banks, insurance companies -- and even commercial enterprises -- that existed when the laws that regulate them today were first written. Inaction, moratoria, and incremental legislation are not the answer. Comprehensive legislation is needed.

Two Way Street

Dean Witter has long been a strong supporter of comprehensive financial services legislation that would remove all barriers to affiliations between banks and nonbanking entities. Today, perhaps more than ever before, legislation is needed to permit even-handed competition among all financial services providers.

The entry of banks into the securities business is occurring at an accelerating pace, as regulators remove barriers once thought to be based on statutory mandates. Over the past decade, regulators have permitted banks to act as securities brokers and investment advisors and engage in a wide range of securities activities. The Federal Reserve Board determined last year that bank holding companies may derive up to 25% of their revenues from corporate equity and debt underwriting by securities affiliates, a decision which cleared the way for the proposed acquisition by Bankers Trust of Alex. Brown. The Office of the Comptroller of the Currency is now considering an application to approve the underwriting of bank ineligible securities directly in a bank subsidiary.

Meanwhile, the ability of securities firms to enter the banking business remains limited. Securities firms are permitted to affiliate with FDIC-insured financial institutions with limited charters. Dean Witter operates a number of these institutions. But, like other securities firms, we are restricted from commercial bank ownership, and cannot offer our clients a full range of banking services.

The establishment of a “two way street” allowing securities firms to compete on an equal footing with banks requires a removal not only of the Glass-Steagall restrictions, but modification of Bank Holding Company Act restrictions against bank affiliations with businesses that are not “closely related to banking.” This includes not only financial services businesses, but also nonfinancial activities.

A decision by Congress to retain existing restrictions means that the goal of competitive equality will not be achieved, because most nonbanking organizations are engaged to some degree in nonfinancial, even commercial, activities. For that reason, we believe that the best choice is simply the removal of all restrictions against bank affiliations, including affiliations with commercial enterprises. The ownership by commercial firms of thrift institutions, limited-purpose “CEBA” banks, credit card banks, industrial loan companies, and trust companies over the past two decades demonstrates that existing affiliate transaction restrictions, capital requirements and other limitations have effectively guarded against the risks that have been raised by advocates of a strict separation of banking and commerce.

The approach of allowing financial services holding companies to engage only in permissible “financial” and limited “nonfinancial” activities, while preferable to a ban on nonfinancial activities, creates its own set of problems. To allow innovation and the efficiencies of mergers and acquisitions, such an approach must define financial activities broadly enough to encompass communications, computer and other emerging technologies that will be used to serve consumers of financial services in the future. Another complication with such an approach is the need to allow a "basket" of nonfinancial activities large enough to permit financial services holding companies to continued operate, and to expand in the future, nonconforming businesses that represent no potential danger to a bank affiliate.

Functional Regulation of Financial Services

Barriers to affiliations among banks, securities firms, insurance companies and others must be replaced by a framework which regulates holding company affiliates depending on the scope of the activities in which they engage. Subsidiaries of a financial services holding company should be regulated by those with the expertise in the activity conducted by the subsidiary, and the greatest experience in assessing risks associated with such activities: bank regulators, the Securities and Exchange Commission, securities industry self-regulatory organizations, state insurance commissioners. This not only provides competitors with a level playing field, but ensures that consumers and investors have the same level of protection and regulatory oversight regardless of the source from which a product or service is obtained.

For example, a consumer who invests in securities should receive the same disclosures, and have the same investor protections, whether he or she deals with Dean Witter, a bank, a mutual fund or an insurance company. Employees who sell securities should be subject to the same licensing and supervision regardless of whether their employer is a bank, an insurance company or a securities firm. The same rule should apply to insurance products, certificates of deposit and other financial services. Having said this, I must also caution that consumer protection requirements in the financial services arena must be looked at carefully to make sure that it is really consumers, not competitors, who are seeking protection.

Holding Company Oversight

There seems to be general agreement among Congress, regulators and financial services providers with the concept of "functional regulation." Each of the principal bills introduced to date (H.R. 10, H.R. 669, H.R. 268) includes some form of functional regulation. But there are some advocates for the creation of an additional layer of holding company oversight in the form of an "umbrella supervisor." Today, this regime applies only to bank holding companies, and even its supporters acknowledge that many of its features may be inappropriate when nonbanking affiliates are involved. We urge the Subcommittee to reject this approach, and to look instead to other models --such as the unitary thrift holding company -- where financial institutions' have successfully affiliated with nonbanking business without an umbrella supervision, examination and application authority.

Surely there is a need in any model for mechanisms to address legitimate concerns about the impact of the activities of bank affiliates and of "risk management" decisions made at the holding company level, on insured banks (or the payments system, or the deposit insurance system). Most of these concerns are addressed by existing statutory and regulatory requirements.[2] To the extent that additional safeguards are needed, they can be devised without imposing an additional level of capital requirements or subjecting bank affiliates to reporting, supervision, or application requirements imposed by another federal regulator.

The approach taken by H.R. 669 ("Depository Institution Affiliation Act of 1997") and H.R. 268 ("Depository Institution Affiliation and Thrift Charter Conversion Act") is preferable. These bills would establish a National Financial Services Committee, whose membership would include the Secretary of the Treasury, bank regulators, the SEC, and insurance commissioners to coordinate policy and regulatory issues. This Committee would serve as the focal point for the exchange among regulators of information they acquire from the entities they supervise or examine, and would allow a coordinated response to activities that might endanger an insured bank affiliate. For example, if a "risk assessment" report obtained by the SEC from a securities firm (pursuant to the requirements of the Market Reform Act of 1990) revealed activities that could endanger

[2] For example, Sections 23A and 23B of the Federal Reserve Act restrict certain transactions between banks and affiliates and impose "arm's length" requirements on extensions of credit to affiliates. The "prompt corrective action" requirements of the Federal Deposit Insurance Corporation Improvement Act require bank regulators to require additional capital to be placed in undercapitalized banks and to take such steps as curtailing asset growth, restricting dividends and mandating bank divestiture. Current law authorizes the FDIC to examine and investigate affiliates of insured banks to determine the relationship of the affiliate to the bank and its impact on the bank. With respect to securities and derivatives activities, oversight is provided by such requirements as the SEC's risk assessment rules.

the firm or, ultimately, an affiliated bank, this information could be used as a basis for action by both the Commission and the bank's regulator.

Securities firms are in the business of risk taking, and investor protection regulation is focused primarily on disclosing the nature of the risk. Subjecting us to a regulatory regime designed to insure bank safety and soundness and avoid risk is both fundamentally inconsistent with our business and unnecessary to address concerns about the impact of our activities on affiliated financial institutions.

The structure reflected in H.R. 669 and H.R. 268, which gives bank regulators access to the information they need to assess the potential impact on bank affiliates of the activities of other holding company entities is a sound one. The combination of effective functional regulation, risk assessment procedures and coordinated regulatory efforts are far preferable to the anointing of a superregulator to oversee the activities of a diversified financial services business.

Conclusion

In the absence of an updated regulatory structure, the costs of providing convenient and efficient sources of financial services are high. Consumers and investors are being deprived of the benefits that technology and marketplace innovation can make available. I urge the Subcommittee to move quickly towards the enactment of legislation creating a regulatory environment that will allow all segments of the industry to focus on serving the needs of consumers and investors.